

BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Wisconsin Energy Corporation)	
for Approval of a Transaction by which)	
Wisconsin Energy Corporation Would Acquire)	Docket No.: 9400-YO-100
All of the Outstanding Common Stock of)	
Integrus Energy Group, Inc.)	

**SURREBUTTAL TESTIMONY OF
JOHN J. REED IN SUPPORT OF APPLICATION
BY WISCONSIN ENERGY CORPORATION**

I. INTRODUCTION AND PURPOSE

Q. Please state your name, affiliation, and business address.

A. My name is John J. Reed. I am Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric") and CE Capital, Inc. located at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. Have you previously filed testimony in Docket No. 9400-YO-100?

A. Yes. I submitted both direct and rebuttal testimony on behalf of Wisconsin Energy Corporation ("WEC") to address how WEC's proposed acquisition of Integrus Energy Group, Inc. ("Integrus") (the "Transaction") is in the best interests of utility customers, investors and the public.

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. The purpose of my surrebuttal testimony is to respond to certain aspects of the rebuttal testimonies of (1) Staff of the Public Service Commission of Wisconsin ("Commission") ("Commission Staff") witnesses Lois Hubert, Jodee Bartels, Kenneth Detmer, and Kevin O'Donnell, (2) Citizens Utility Board ("CUB") witness Richard Hahn, (3) Wisconsin

1 Industrial Energy Group, Inc. (“WIEG”) witness Lane Kollen, and (4) Jobs4WI witness
2 Steven Vock. In particular, I will respond to these witnesses’ rebuttal testimony
3 regarding: (1) Wisconsin’s merger approval standard and how the proposed merger
4 satisfies that standard; (2) the benefits, costs and purported risks of the proposed
5 transaction; (3) the financial strength of WEC Energy Group; and (4) tracking merger
6 savings and transition costs and providing for their future ratemaking treatment.

7 **II. SUMMARY AND OVERVIEW OF SURREBUTTAL TESTIMONY**

8 Q. Do you have any opening comments you would like to make to provide context for your
9 surrebuttal testimony?

10 A. Yes, I do. The Staff and interveners have submitted hundreds of pages of rebuttal
11 testimony, the vast majority of which repeats positions and assertions made in their direct
12 testimony. Rather than respond witness-by-witness to each point repeated in rebuttal, I
13 will address these points thematically and will address more specifically those limited
14 places where interveners articulated new positions.

15 Q. After reviewing all of the evidence that has been submitted in this docket, what is your
16 overall view of the proposed Transaction?

17 A. I believe that both companies (WEC and Integrys) are taking a responsible and
18 reasonable approach to merger integration, and to provide benefits to customers while
19 also ensuring that various stakeholder interests are considered and reflected in post-
20 merger commitments. At the end of the day, this Transaction has distinctly favorable
21 characteristics that reflect a balanced and thoughtful approach to the issues of customer
22 service, corporate responsibility, employee protections, and economic and financial
23 protections, while creating and preserving very significant opportunities to produce and
24 pass through material savings. Without the proposed Transaction, none of these

1 opportunities would exist. To criticize the proposed Transaction because the benefits are
2 not immediate, or known with certainty, or guaranteed up front, is to lose perspective on
3 all of the very real benefits that make the merger in the best interests of utility customers
4 and the State of Wisconsin. Importantly, neither Staff nor any of the intervenors have
5 demonstrated with evidence any downside to the proposed Transaction.

6 Q. Please summarize your surrebuttal testimony pertaining to Wisconsin's merger approval
7 standard and how the proposed transaction satisfies that standard.

8 A. All agree that the standard for approval of the merger is Wisconsin Statute 196.795(3),
9 which requires that a transaction be "in the best interests of utility consumers, investors
10 and the public". Intervenors interpret "best interests" to mean significant and in some
11 cases immediate rate reductions to customers. One intervenor, Mr. Vock, even goes so
12 far as to state that reliability should not be considered when applying the "best interests"
13 standard because the Wisconsin utilities already provide reliable service. The intervenors
14 take the position that the merger will, however, satisfy even the intervenors'
15 interpretation of the standard, which Staff witness Bartels acknowledges has "evolved", if
16 WEC's shareholders agree to further economic concessions. The justification offered for
17 this position is that WEC is a well-run company with a history of strong earnings, and
18 that WEC paid an acquisition premium for Integrys and paid advisors in connection with
19 the transaction, therefore WEC should also pay customers in the form of immediate rate
20 reductions. This is neither a reasonable application of the statutory standard nor good
21 public policy. Further, this is a very dangerous game of brinksmanship which could deny
22 customers the many benefits of this transaction and cast a shadow on the regulatory risk
23 of doing business in Wisconsin. As an example, to enact one of the proposed conditions,

1 i.e., an immediate 5% reduction in non-fuel O&M costs, or \$78 to \$130 million, the
2 immediate layoff of approximately 1000 employees would be required. As discussed by
3 Mr. Leverett, WEC has consistently indicated that it is not going to take a “slash and
4 burn” approach to synergy savings, but rather intends to achieve savings over time
5 through careful integration and natural employee attrition. The “best interests” of
6 customers, investors and the public are achieved if the benefits of the transaction exceed
7 its costs and risks. Benefits must be looked at as a whole and over time. As I
8 demonstrated in my prior testimony and discuss later in this testimony, by any rational
9 assessment the proposed transaction far exceeds this threshold.

10 Q. Please summarize your surrebuttal testimony pertaining to the benefits, costs and
11 purported risks associated with the proposed merger.

12 A. In support of their various proposals for immediate rate reductions, the write-off of
13 transmission cost deferrals, a retrospective claw-back of company earnings, and onerous
14 conditions on future ratemaking and other conditions, the Staff and interveners have (1)
15 made numerous unsubstantiated claims of possible risks and costs to customers, (2)
16 mischaracterized or misunderstood utility finance and ratemaking, and (3) made
17 numerous accusations that the Company does not/will not operate in the best interest of
18 customers. Incongruous with these assertions, one witness also asserts that WEC may
19 experience a windfall in merger-related benefits prior to the filing of its first rate cases,
20 while another criticizes Wisconsin Public Service Corporation (“WPS”) for not pursuing
21 and realizing the benefits of joint resource planning now, before the merger has been
22 approved. The interveners are very mistaken. The Company has reasonably
23 demonstrated the breadth of benefits, including cost savings, which are likely to accrue to

1 customers over time. Customers are not exposed to any transaction cost recovery risk,
2 and transition cost recovery will only be sought to the extent merger savings exceed those
3 costs. Shareholders will pay all transaction costs, including transaction fees, in order to
4 unlock future benefits for utility customers, investors and the public. WEC will pursue,
5 and customers will enjoy the benefits of the merger, including cost savings, over time.
6 And the Commission will continue to have full regulatory oversight and authority over
7 the jurisdictional utilities following the merger just as it does today (e.g., base rates
8 cannot change unless the Commission allows it).

9 Q. Please summarize your surrebuttal testimony pertaining to the financial strength of WEC
10 Energy Group.

11 A. Staff and interveners argue that there is a substantial risk that WEC's credit rating will be
12 downgraded as a result of the merger. They go on to argue that even if there is no
13 downgrade, the credit metrics of WEC Energy Group will deteriorate and the Company's
14 financial strength may never be restored. Again, the Staff and interveners' opinions are
15 not supported by the facts. Rating agencies have taken a favorable view of the
16 Transaction over the long term, and have indicated that they do not expect to downgrade
17 the rating of WEC Energy Group as a result of the acquisition-related debt. Equity
18 analysts have also favorably commented on the acquisition, and have noted that it
19 benefits both customers and shareholders. Furthermore, the Commission is fully able to
20 ensure that any merger-related credit degradation, unlikely as it is to occur, will not
21 adversely affect customers.

22 Q. Please summarize your surrebuttal testimony pertaining to the tracking and ratemaking
23 treatment of merger savings and transition costs.

1 A. Staff and interveners criticize WEC's estimate of potential merger-related savings and its
2 proposed process for monitoring savings, and the costs to achieve them. WEC has
3 provided a valid and credible estimate of potential merger-related savings. The
4 Company's plans and processes for monitoring, measuring and reporting merger-related
5 savings and transition costs necessary to achieve those savings are reasonable and
6 consistent with what I would expect from a transaction of this kind. The status of the
7 Company's integration plans is also reasonable given that the merger is not premised on
8 immediate savings and that the Transaction has not closed. WEC has made it clear that it
9 intends to pursue savings over time, to minimize employee disruptions, and that all of
10 these savings, net of transition costs, will be flowed to ratepayers in subsequent rate
11 cases. In addition, no transition costs will go into rates unless they produce savings that
12 exceed costs so customers can really only benefit from the Transaction. Finally, these
13 reports will be subject to regulatory scrutiny, including the scrutiny of the Staff and
14 interveners. The Commission has all of the tools it needs to insure that this will happen;
15 the Company has also committed that sufficient information will be provided to insure
16 that all of these commitments have been met. If the Commission isn't convinced that
17 savings exceed transition costs, WEC understands that transition costs won't be
18 recoverable through rates.

1 **III. RESPONSE TO STAFF AND INTERVENERS**

2 **Merger Approval Standard**

3 Q. Do you agree with Staff’s and interveners’ suggestion that you are applying a “no net
4 harm” standard rather than a “best interests” standards?

5 A. No, I do not. I have never suggested that Wisconsin has a “no net harm” standard for
6 merger approval. Rather, my position has been and continues to be that the “best
7 interests” standard is achieved by demonstrating benefits to customers, which WEC has
8 done. The point of contention between the Company and interveners appears to be when
9 those benefits will be achieved. Staff and interveners want immediate savings on Day 1,
10 but that can likely only be achieved through layoffs, which WEC has indicated it will not
11 do and which is not in the best interests of customers or the public, or through
12 confiscation of dollars from shareholders, which is neither appropriate nor (I’m advised)
13 lawful. As discussed throughout my direct and rebuttal testimony, the benefits of this
14 merger are longer-term in nature. WEC and Integrys have taken a thoughtful approach to
15 the merger, balancing the issues of customer service, corporate responsibility, employee
16 protections and economic and financial protections, while creating and preserving very
17 significant opportunities to produce and pass through material savings. Without the
18 merger, none of these opportunities would exist. The Transaction satisfies the “best
19 interests” standard in Wisconsin.

20 **Savings/Benefits from the Merger**

21 Q. How do you respond to Staff’s and intervener’s concern that there will not be any cost
22 savings from the merger, and the contention that WEC is focused on providing

1 shareholder benefits (through higher dividends and increased earnings growth) rather
2 than customer benefits?

3 A. WEC has explained how benefits and cost savings can be achieved from this type of
4 merger through joint resource planning, joint procurement, sharing and implementing
5 best practices across operating utilities, and consolidating administrative and general
6 functions, among other things. As shown on Chart 3 of my direct testimony, savings
7 from similar mergers in recent years have been estimated to be between 3-5% of non-fuel
8 O&M costs over what they would be otherwise. In particular, the recent merger of
9 Northeast Utilities and NSTAR, which also was not predicated on immediate cost
10 savings, was projected to result in long-term savings of approximately 5% of non-fuel
11 O&M costs. Furthermore, both WEC and Integrys have successfully completed merger
12 integrations in the past. While I agree that the proposed Transaction provides benefits to
13 shareholders (which is also an element of the “best interests” standard), the merger also
14 provides substantial benefits to customers and the public that would not be possible
15 absent the merger.

16 Q. Staff and interveners contend that it is not reasonable to assume that the proposed
17 Transaction will result in more than \$600 million in savings from combining the
18 generation resources of WEPCO and WPS because there is no plan to combine the two
19 utilities. What is your response?

20 A. The entire basis for this argument is Staff witness Detmer’s statement that joint resource
21 planning is not occurring now.¹ My response is that this is not surprising because the
22 merger has not yet been approved. Joint resource planning, and all of the other benefits

¹ Rebuttal Testimony of Kenneth Detmer, at 1.

1 of the merger, cannot accrue until after the merger is approved and closes. That does not
2 change the fact that combining the generation resources of WEPCO and WPS is expected
3 to produce significant savings, estimated by Mr. Detmer in his direct testimony to be in
4 the range of \$600 million.

5 Q. Staff witness Detmer testifies that for any savings to be realized from joint resource
6 planning, it is not enough to simply model an integrated approach; rather, the utilities
7 would need to actually implement the least cost option, which the applicant has not
8 committed to do. What is your understanding of WEC Energy Group's plans in that
9 regard?

10 A. My understanding is that WEC will perform least cost planning and implement the least
11 cost option at the direction of the Commission.

12 Q. Staff witness O'Donnell states that compared to the \$2.4 billion acquisition premium paid
13 to Integrys and the \$47.6 million paid to Integrys management in change of control
14 payments, the consumer benefits proposed by Staff are rather modest. CUB witness
15 Hahn asserts that one way to measure an appropriate level of benefits for Wisconsin
16 ratepayers is that they should be at least as great as the benefits to lawyers and investment
17 bankers of consummating the transaction (which are estimated to be \$38 million, not
18 \$236 million as suggested by Mr. Hahn). What is your response to these points?

19 A. In my view, the financial terms of the Transaction have no direct connection to the
20 customer benefits that are ultimately achieved as a result of the merger. I want to begin
21 by making sure that the facts are clear. The \$2.4 billion acquisition premium, which is
22 the difference between the book value of the acquired assets and the acquisition price, is
23 not entirely the product of the acquisition. Integrys' stock price was substantially above

1 its book value before the acquisition was announced. Second, the transition costs do not
2 constitute a gift or gratuity for the lawyers or bankers involved; those are fees for
3 services. WEC has provided a reasonable basis to support its claim that net savings will
4 be provided to customers over the longer term, and that Wisconsin customers will receive
5 those savings over time in future rate proceedings. However, those savings will not occur
6 immediately, and should not be compared against payments for services or for stock that
7 have been made to effectuate the merger.

8 Q. Do you agree with CUB witness Hahn that the regulated utility subsidiaries will be asked
9 to indirectly fund the acquisition premium because they will need to raise additional debt
10 to finance capital investments since WEC plans to increase the dividend payout ratios of
11 WEPCO, WPS and WG?

12 A. Absolutely not. WEC has committed that it will not seek recovery of the acquisition
13 premium through any means. Furthermore, there is no evidence or support for Mr.
14 Hahn's position that the regulated utilities will need to issue new debt to finance capital
15 investments because they will be paying higher dividends to WEC Energy Group. As I
16 have stated in my direct and rebuttal testimony, an important benefit of the Transaction is
17 that it gives WEC the financial flexibility to deploy its excess cash flow to fund the
18 capital investment projects of the operating utilities of both WEC and Integrys. The
19 expanded use of these internally-generated funds is a distinct advantage created by the
20 merger, and will make the combined company financially stronger because the utilities
21 will not need to access external capital markets to finance these investments.

22 Q. Staff and interveners continue to argue that if the Commission approves the acquisition
23 without requiring a demonstration of immediate net benefits to consumers it should

1 ensure that there are benefits through a write-off of the transmission escrow accounts or
2 through bill credits. What is your response?

3 A. For the reasons discussed in my rebuttal testimony, these draconian steps are unnecessary
4 and inappropriate. If the merger had not been proposed, no party would be asking the
5 Commission to write off the transmission escrow or asking WEC to refund money to
6 customers. The merger should not be used as a platform for parties to leverage regulatory
7 concessions that would otherwise be out of the question.

8 Q. Mr. O'Donnell refers to a "preliminary financial analysis" performed on behalf of the
9 Integrys Energy board of directors as support for his recommendation for immediate
10 savings to customers. What is your response?

11 A. The analysis referred to by Mr. O'Donnell on page four of his rebuttal testimony is, I
12 believe, the confidential presentation referred to by witness Hahn on page 15 of his direct
13 testimony. It is my understanding that this presentation provided the Integrys Energy
14 board with a representative level of savings which might be achieved by the merger
15 which was determined in much the same way I produced my estimate relying upon
16 experiences in other mergers. The presentation was based on publicly-available
17 information about other similar transactions, and was not the result of analysis of this
18 particular transaction. The sharing of savings referred to by each of witnesses O'Donnell
19 and Hahn were simply assumptions made by the consultant who prepared that analysis
20 and are irrelevant to this proceeding. WEC proposes that 100% of net savings be flowed
21 to customers through rates in normal rate case proceedings. Further, neither witness
22 acknowledges that this presentation also refers specifically to transition costs necessary to

1 achieve the estimated savings. Nothing in this presentation supports these witnesses'
2 proposals for immediate rate reductions.

3 Q. Jobs4WI witness Vock contends that Wisconsin customers are not asking for better
4 reliability, so the only possible benefit that the merger can provide is lower electricity
5 costs. Based on this premise, Mr. Vock recommends that non-fuel O&M costs should be
6 reduced by 5% below current levels for each utility for the upcoming 2017 test year.
7 What is your response?

8 A. Mr. Vock should consider the likelihood that WPS's reliability might be improved by
9 implementing the best practices of WEPCO, which is rated even higher for reliability.
10 Mr. Vock's recommendation to reduce the non-fuel O&M expenses for each utility by
11 5% below current levels fails to consider that the current rate levels are based on test year
12 costs that have been approved by the Commission and that have been shown to be
13 reasonable. I agree that customers should see some benefits from the Transaction;
14 however, forcing those benefits by acting in a punitive fashion towards stockholders is
15 not reasonable or equitable. Once net savings are achieved from the Transaction over
16 the longer term, those savings will be flowed through to Wisconsin ratepayers in future
17 rate cases. Since there will be little or no immediate savings, an immediate rate reduction
18 in the amount of 5% of non-fuel O&M costs for the 2017 test year, as proposed by Mr.
19 Vock, is simply not justified.

20 Q. How do you respond to Jobs4WI witness Vock's testimony that in your study of WEC's
21 WICOR merger "savings" from 2001 to 2004, you demonstrated \$71.2 million of
22 savings; however, non-fuel O&M costs actually increased from \$583 to \$740 million
23 during this period?

1 A. As Mr. Vock correctly points out, my analysis in that 2005 study, which was filed with
2 the Commission, compared actual costs to the projected costs that would have been
3 incurred absent that merger. This is the appropriate point of comparison. In that
4 instance, my analysis demonstrated that \$71.2 million in savings was attributable to the
5 merger, meaning that O&M costs would have increased to \$811 million, but for the
6 merger. In the current Transaction, based on similar mergers that have occurred in recent
7 years, it is reasonable to expect savings in the range of 3-5% of non-fuel O&M costs over
8 what they would be otherwise. The fact that non-fuel O&M costs increased after the
9 WICOR merger does not diminish the benefit that was achieved by the merger.

10 Q. Please summarize your surrebuttal testimony with regard to the various ring-fencing
11 recommendations that have been put forth by Staff and interveners.

12 A. All of the ring-fencing recommendations proposed by Staff and interveners fail to reflect
13 the reality of modern utility finance. For example, the fact that regulated utilities pay
14 dividends to a parent company or issue new debt does not change the rates that customers
15 pay. Customer rates are set by the Commission, which can consider and respond to any
16 risk that arises that could affect those rates. WEC has made a clear commitment that no
17 adverse effects of the merger, if there are any, will flow into customer rates, and the
18 Commission already has all of the tools it needs to insure that this commitment is
19 honored, without imposing additional ring-fencing requirements. For these reasons, I do
20 not believe that any additional ring-fencing measures should be required.

21 **Risks Associated with the Merger**

22 Q. How do you respond to Staff and intervener witnesses who take the position that WEC is
23 asking Wisconsin consumers to accept risks associated with the merger, including the

1 risk that savings will not ultimately result from the merger, and the risk that a credit
2 rating downgrade will lead to higher financing costs?

3 A. The only way to achieve immediate savings is through layoffs, which WEC has indicated
4 it will not do, and which would not be in the best interests of customers, employees or the
5 public. As such, upfront bill credits are not justified because the regulated utilities' O&M
6 costs will not be reduced in the first year after the merger is completed. Similarly, as
7 discussed in more detail later in my surrebuttal testimony, all of the evidence to date is
8 that any type of a credit downgrade is unlikely, and that the long-term consequences of
9 the merger will be positive for bondholders. However, in the remote possibility that there
10 is a downgrade at some level in the holding company that is attributable to the merger,
11 the Commission is fully able to insulate customers from shouldering any type of burden
12 from such an event. The risk, in other words, is a risk to shareholders, not to utility
13 customers.

14 Q. Do you agree with Staff witness O'Donnell that upfront bill credits will provide a strong
15 incentive for the applicant to minimize costs of the merger integration process?

16 A. No, I do not. Contrary to Mr. O'Donnell's testimony, the Applicant already has every
17 economic and financial incentive to minimize merger integration costs. WEC has
18 proposed to track and monitor transition costs and to file reports with the Commission on
19 an annual basis, so that Staff and interested stakeholders are fully aware of the costs that
20 are being incurred to achieve savings. Staff and other parties will have an opportunity to
21 scrutinize and challenge the reasonableness of those transition costs, and the Commission
22 retains the authority to disallow any transition costs that it deems to be unreasonable or

1 that will not produce net savings. The incentive to avoid such a disallowance is all the
2 incentive that is needed.

3 Q. Staff witness O'Donnell clarifies Staff's rebuttal position that it is important for the
4 Commission to consider WEPCO's past strong earnings in order to assess the health of
5 the company and its ability to offer consumers upfront compensation, but claims that
6 nothing in Staff's recommendation involves recovery of WEPCO's past earnings. Do
7 you agree with this position?

8 A. No, I do not. Staff seems to be suggesting that, because WEPCO has the financial ability
9 to refund money to customers, it should be ordered to do so as a condition of gaining the
10 Commission's approval for the proposed Transaction. I do not believe the past earnings
11 of WEPCO should have anything to do with whether the merger is in the best interests of
12 customers and the public. The merger standard of "best interests" does not imply such a
13 requirement, and WEC has already demonstrated how the merger is expected to result in
14 long-term benefits for utility customers, the public and investors.

15 **Financial Strength of Combined Company**

16 Q. Staff and interveners question whether the transaction will cause the financial strength of
17 WEC Energy Group to deteriorate. In particular, Staff argues that the potential for a
18 credit downgrade is a significant risk created by the Transaction, and that ratepayers
19 should be compensated for this risk through some immediate benefit such as rate credits.
20 What is your response to these concerns?

21 A. As discussed in my rebuttal testimony, the credit rating agencies (Standard and Poor's,
22 Moody's Investors Service, and Fitch Ratings) have all stated that they do not expect the
23 acquisition-related debt to lead to a credit downgrade for WEC, and that they consider the

1 Wisconsin operating utilities to be sufficiently insulated from the parent holding
2 company so that any downgrade of WEC would not affect the regulated utilities. For
3 these reasons, I disagree with Mr. O'Donnell that it is reasonable to order the utilities to
4 issue bill credits to compensate customers for a risk at the holding company level that is
5 unlikely to ever materialize. In addition, because the Commission has the ability to
6 insulate utility customers from any adverse rating impacts of the merger, in the unlikely
7 event that such an impact arises, it is actually shareholders, not utility customers that bear
8 this risk.

9 Q. Do you agree with Staff witness Hubert's assertion that even if WEC Energy Group is
10 not downgraded, the credit metrics of the combined company will deteriorate and the
11 company's financial strength may never be restored?

12 A. No, I do not. Ms. Hubert has provided no evidence or support for this opinion.
13 Furthermore, as explained in my rebuttal testimony, Ms. Hubert's view is not consistent
14 with the reports issued by credit rating agencies or equity analysts who have analyzed the
15 proposed merger and found it to be favorable for both investors and customers. For
16 example, Zacks Investment Research commented: "Both the utilities, Wisconsin Energy
17 and Integrys Energy **along with their customers** and investors stand to benefit from the
18 proposed transaction." ²

19 Q. Staff and interveners argue that WEC should assume the risk of a credit downgrade, and
20 that it is not reasonable to argue that the downgrade might be caused by anything other
21 than the acquisition itself. What is your response?

² Zacks Investment Research, "Wisconsin Energy to Buy Integrys to Expand Midwest Operations – Analyst Blog," June 24, 2014, as reported by Thomson Reuters. Emphasis added.

1 A. Acquisition-related debt is not the only possible reason that a credit downgrade might
2 occur after a merger. As discussed in my direct testimony, credit rating agencies have
3 also expressed concern about the effect that regulatory conditions imposed on mergers
4 have on the post-transaction cash flows of the new company. For example, the credit
5 ratings of Connecticut Light and Power and NSTAR Electric were downgraded due to
6 concerns about conditions imposed by regulators in Connecticut and Massachusetts on
7 the merger of Northeast Utilities and NSTAR.³ I do not believe it is reasonable for WEC
8 to assume any risk associated with a potential credit downgrade that might occur due to
9 events that are beyond its control.

10 Q. How do you respond to several interveners (CUB witness Hahn and Jobs4WI witness
11 Vock) who contend that you have not provided any evidence that creating a larger
12 holding company will enhance access to capital for the regulated utilities?

13 A. As discussed in my rebuttal testimony, credit rating agencies and equity analysts have
14 indicated that increased size is an important consideration for investors.⁴ Furthermore, in
15 the case of Mr. Hahn's analysis, he only considers credit ratings and market
16 capitalization, and fails to consider the perspective of equity investors. I continue to
17 believe that investors consider larger companies to have better access to capital, and that
18 as utility industry consolidation continues, this becomes even more important for the
19 remaining companies.

³ Direct Testimony of John J. Reed, at 23-24.

⁴ Rebuttal Testimony of John J. Reed, at 29-31.

1 **Tracking Savings and Costs**

2 Q. WIEG witness Kollen expresses concern that WEC has not identified or quantified
3 transition costs or savings, and that WEC’s proposal to track transition costs and savings
4 for ratemaking purposes is an undeveloped concept that does not provide any baseline
5 against which to objectively measure costs. In addition, Mr. Kollen argues that since
6 there are no estimates of achievable savings it is relatively easy to subjectively quantify
7 savings and claim that those savings are attributable to the merger. What is your
8 response?

9 A. WEC’s proposal to track savings and costs is intended to allow the Commission, Staff
10 and other interested parties to monitor the actual savings that are being realized as a result
11 of the merger, as well as the costs that are being incurred to achieve those savings. WEC
12 has provided estimates of what savings might be expected from the Transaction based on
13 similar mergers in the past. Transition costs and transaction costs have been defined in
14 the application. A very similar tracking mechanism for savings and costs was adopted by
15 the Connecticut regulatory authority in the recent merger of Northeast Utilities and
16 NSTAR. I believe it is an effective and efficient method for tracking and monitoring
17 savings and transition costs, so that the process is transparent to all interested parties. In
18 addition, WEC has accepted that the consequences of not being able to track savings and
19 costs rests on shareholders, since the utilities will bear the burden of showing that net
20 savings were produced in order to recover any transition costs.

21 Q. WIEG witness Kollen also argues that WEC’s proposal to track savings and costs may
22 allow WEPCO and WPS to defer transition costs and recover those costs through
23 “savings.” Mr. Kollen contends that WEC should not be allowed to implement deferral

1 accounting for transition costs without a formal proposal to modify the application. What
2 is your response?

3 A. It is my understanding that no deferral of transition costs could occur without approval by
4 the Commission, and WEC has not sought such approval. Therefore, this is not an issue
5 in this proceeding.

6 Q. WIEG witness Kollen argues that WEC's definition of transaction costs is unduly
7 restrictive and is limited to costs incurred prior to and including consummation of the
8 merger. Mr. Kollen recommends that the Commission broaden the definition of
9 transaction costs to include other costs that occur after the merger is completed, and put
10 WEC on notice that those costs will not be recoverable in future rate cases. What is your
11 response?

12 A. WEC has committed that it will not seek recovery of transaction costs, as that term was
13 defined in the application and in my direct testimony. This includes change of control
14 payments that are triggered by the merger. Any costs that are incurred after the merger is
15 completed are transition costs attributable to the merger integration process and, in my
16 view, should be recoverable to the extent that savings exceed those costs.

17 Q. Please summarize your surrebuttal testimony as it relates to Staff and intervener concerns
18 that savings will not be achieved and/or transition costs will be recovered from customers
19 regardless of savings.

20 A. WEC has made it clear that they intend to pursue merger savings over time, to minimize
21 employee disruptions, and that all of these savings, net of transition costs, will be flowed
22 through to ratepayers in subsequent rate cases. In addition, no transition costs will go
23 into rates unless they produce savings that exceed those costs. Therefore, customers can

1 only benefit from the merger; they cannot be worse off because of the merger. The
2 Commission has all the tools it needs to insure that this will happen. WEC has also
3 committed to provide sufficient information to insure that all of these commitments have
4 been met. If the Commission isn't convinced that savings exceed transition costs, WEC
5 understands that transition costs won't be recoverable through rates.

6 Q. Does this conclude your surrebuttal testimony?

7 A. Yes, it does.